



SCARBROUGH

**QUESTION/ANSWER FORUM:
THE BASICS OF
INTERNATIONAL TRADE FINANCE**



November 9, 2016



ABOUT THE SPEAKERS



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THE SCARBROUGH GROUP



SCARBROUGH
INTERNATIONAL, LTD.

Est. 1984 International Freight / U.S. Customs

Est. 1988 Own Trucking Fleet



SCARBROUGH
LOGISTICS, LTD.



SCARBROUGH
SIX LINES, LTD.

Est. 2003 NVOCC Operations

Est. 2014 NAFTA Truck Brokerage



SCARBROUGH
TRANSPORTATION, LLC



SCARBROUGH
DE MÉXICO S. DE R.L. DE C.V.

Est. 2015 Freight Forwarder / Mexican Customs



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A large cargo ship is shown from an aerial perspective, sailing on the ocean. The ship is filled with stacks of colorful shipping containers. The water is a deep teal color, matching the overall theme of the slide.

INTERNATIONAL PAYMENT TERMS

Member FDIC

COUNTRY RISK

- Stability
- Sanctions and Embargoes
- Country lists
- Fraud





CUSTOMER RISK

- Legitimate
- Financially sound
 - Financials
 - Credit Reports
 - Trade References
 - Bank References
- OFAC and BIS Lists
- Develop relationship



FOREIGN BANK RISK

- Stability
- Size
- Integrity
- OFAC and BIS lists



METHODS OF PAYMENT

- Cash in Advance
- Open Account
- Documentary Collections
- Letters of Credit



CASH IN ADVANCE

wire transfers, checks, credit cards

- Funds are wired to the seller before the shipment takes place
- Most secured form of payment for the seller
- Buyer must trust that the seller will make the shipment for the items purchased
- Not advantageous if there is strong competition

OPEN ACCOUNT

- Buyer does not pay for the goods until a specified date after shipment
- Best form of payment for the buyer
- Seller must trust that the buyer will make the payment after receipt of the goods
- The problem of collecting payment in a foreign country if payment is not made





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Cash In
Advance

Open
Account



DOCUMENTARY COLLECTIONS

- Also known as “Sight Drafts and Time Drafts” or D/P (documents against payment) or D/A (documents against acceptance), or “Cash Against Documents”
- Goods are shipped, seller presents shipping documents to his **international** bank, seller’s bank presents documents to buyer’s bank for payment
- Banks only facilitate the transaction, they are under no obligation for any payments
- On sight payments, there are ways to help ensure that the buyer does not receive the goods until payment has been made
- Deferred (time draft) payment collections are only one small step above open account shipments. There are not assurances of payment to the seller

DOCUMENTARY COLLECTIONS (CONT)

Banks only facilitate the transaction - they are under no obligation for payments

- **Advantages to Seller**
 - On D/P, Sight Draft, Cash Against Documents, the seller can keep some control
- **Disadvantages to seller**
 - Ships goods without an unconditional promise to pay
 - Goods are in a foreign port if the buyer decides not to accept collection
- **Advantages for the buyer**
 - Payment is deferred until the goods arrive

WHEN TO USE AND NOT TO USE DOCUMENTARY COLLECTIONS

When NOT to use Documentary Collections

- First time buyers
- Volatile countries
- Not reputable banks
- Very large dollar amounts

When to USE Documentary Collections

- Step down from CIA or Letter of Credit
- Have done business with buyer for some time
- Dealers and Distributors
- Favorable Countries and banks

A Letter of Credit is...

An undertaking issued by a bank for the account of a buyer (applicant) to pay the beneficiary provided that the terms and conditions of the L/C are complied with

DOCUMENTARY CREDITS (BETTER KNOWN AS LETTERS OF CREDIT)

“Letters of Credit” (L/C, LOC) are issued for all kinds of different reasons

- When the seller feels insecure with the buyer and his abilities to make payment
- The buyer may want the L/C so he can finance against it
- The country may control movement of funds with letters of credit
- May be the standard way of doing business in that country



DOCUMENTARY CREDITS

- When a bank issues a letter of credit, it is somewhat like a contract between the issuing bank and the beneficiary of the credit. The bank must “honor” and pay if the terms and conditions of the LC are met. The seller is no longer looking to the buyer for payment, but to the buyer’s bank, or the issuing bank for payment
- But to make the contract binding, all the terms and conditions of a letter of credit must be complied with in order for the bank to make the payment
- If the terms of the L/C are not complied with, the issuing bank is no longer liable for the payment and may contact the buyer to approve payment. This reduces the letter of credit transaction to not much more than a simple documentary collection
- If the terms and conditions of the L/C are not complied with the issuing bank has the option of not completing the transaction (sending the documents back to the beneficiary).

Advantages for the Seller

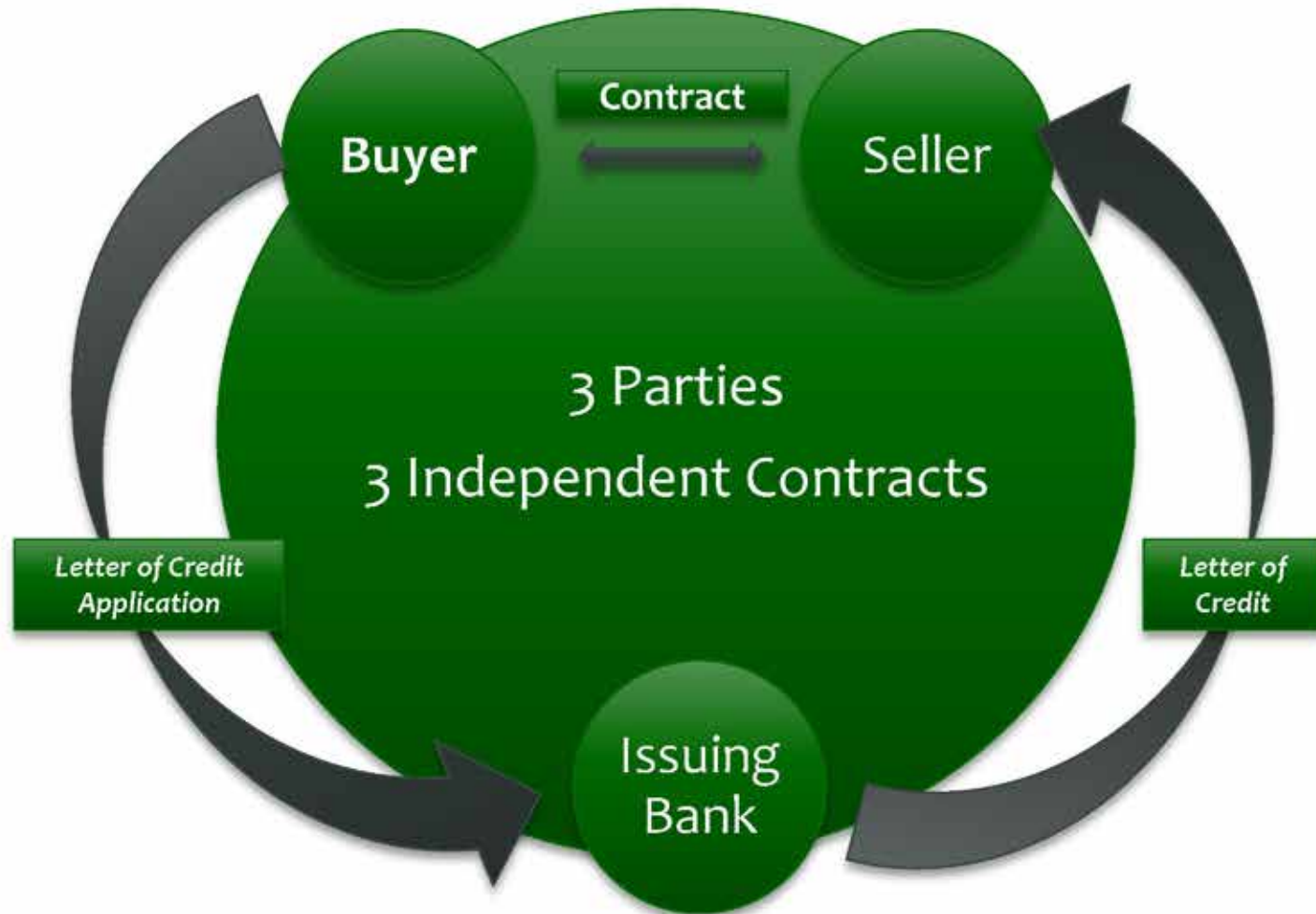
- Provides an independent credit backing with a clear cut promise to pay upon certain conditions
- Substitutes the banks credit standing for the applicant's
- Payment is assured if the terms of the L/C are met
- Protection from order cancellation



Advantages for the Buyer

- Assures that shipment was made according to the terms in the L/C and on time
- Assures that the documents requested in the L/C are provided, otherwise the seller is not in compliance with the L/C
- Payment is not made until goods are shipped and compliant documents are presented or the buyer approves the discrepancies

Contracts Involved in the LC





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COMMERCIAL LETTERS OF CREDIT



- A commercial letter of credit is a sales transaction taking place
- It is an exchange of goods or services for a payment
- Usually a shipment of goods takes place and documents are required to prove the shipment

STANDBY LETTER OF CREDIT

A **Standby** Letter of Credit can be used when there is a chance of default in an underlying transaction.

Examples include:

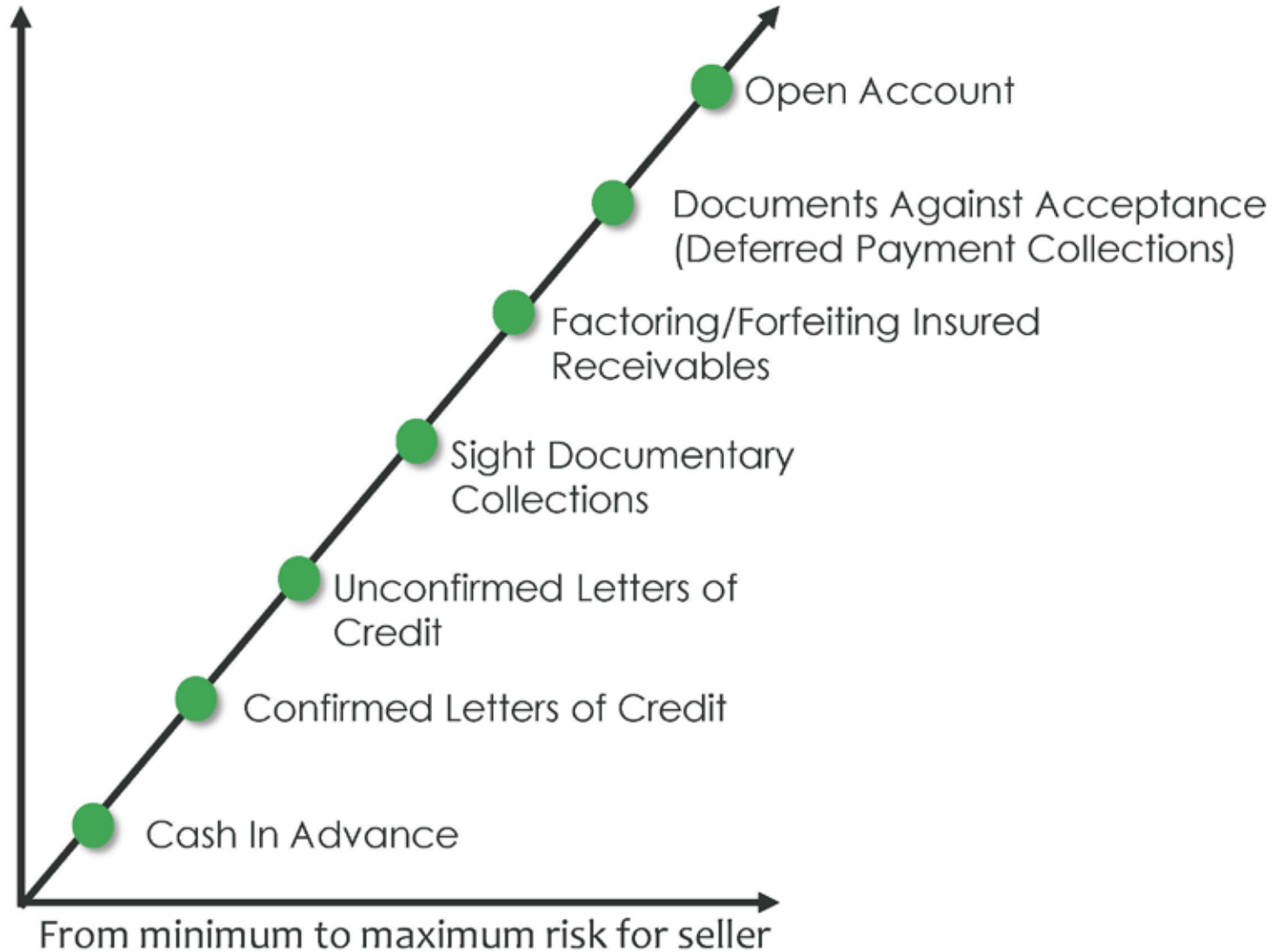
- Replace a bid, surety or performance bond
- Back lease payments
- Back insurance premiums
- Guarantee loan repayments
- Guarantee shipment and installation
- Substitute for advance payments and cash deposits
- Assure a refund of advance payments if contract terms are unmet
- Act as mode of payment



STANDBY CREDITS (CONT)

- They are used domestically more than internationally
- Shipments are not usually involved, and fewer documents are required (draft and certificate of default)
- Bank does not determine fault or performance, but again only deals in **documents**
- Are also known in other countries as “Bank Guarantees” (URDG)

PAYMENT TERMS ARRANGED





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COMMON DOCUMENTS TO A LETTER OF CREDIT

- Draft
- Commercial Invoice
- Transport Document
- Packing List
- Weight List
- Insurance Policy or Certificate
- Certificate of Origin
- Beneficiary's Certificate
- Copy of Fax detailing shipping information
- Other documents as needed for the specific industry or the individual transaction





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An aerial view of a large cargo ship sailing on the ocean, viewed from an elevated angle. The ship is dark and has many containers on its deck. The water is a deep blue-green color.

OPPORTUNITIES & CONSIDERATIONS

Member FDIC

Why Deal in Foreign Exchange?

Depends on your viewpoint

- Active management on receivables may lead to better margins
 - *Hedge portion of anticipated sales (add on as needed)
- Active management on payables may lead to cost savings
 - *Request dual currency invoicing

Pricing flexibility

- Enables overseas clients to compare apples to apples pricing
- Compete against multi national firms with local presence
- Compete against in-country competitors

Keep in mind that some countries only deal in dollars due to restrictions



FX Market Overview

- Largest decentralized asset class with trillions in daily flow
- 4 primary functions: trade, investment, hedging and speculation
- Traded over-the-counter and via exchanges



FX Market Overview

Factors that move the market:

- Economic news
- Central Bank intervention
- Market sentiment and rumors
- Politics



FX Market Overview

Factors that move the market:

- Change in interest rate levels or differentials
- Technical analysis as self-fulfilling prophecy



Foreign Exchange Risk

What is currency risk?

Unexpected changes in exchange rates will:

- Increase cost
- Reduce profit margin
- Create inconsistencies in a company's balance sheet
- Create FX gains or losses on company's income statement



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GBP

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Percent Change: ~21.39%

GBP ↓ 1.2156 -0.0029 ✓ BGN 1.2155 / 1.2157 BGN
 At 10:59 Op 1.2183 Hi 1.2215 Lo 1.2141 Close 1.2185 Value 11/02/16

GBP BGN Currency 99 Compare 90 Actions 97 Edit Line Chart

11/02/2015 - 10/31/2016 Last Price BGN Mov Avg No Lower Chart USD

1D 3D 1M 6M YTD 1Y 5Y Max Daily Table Security/Study Event

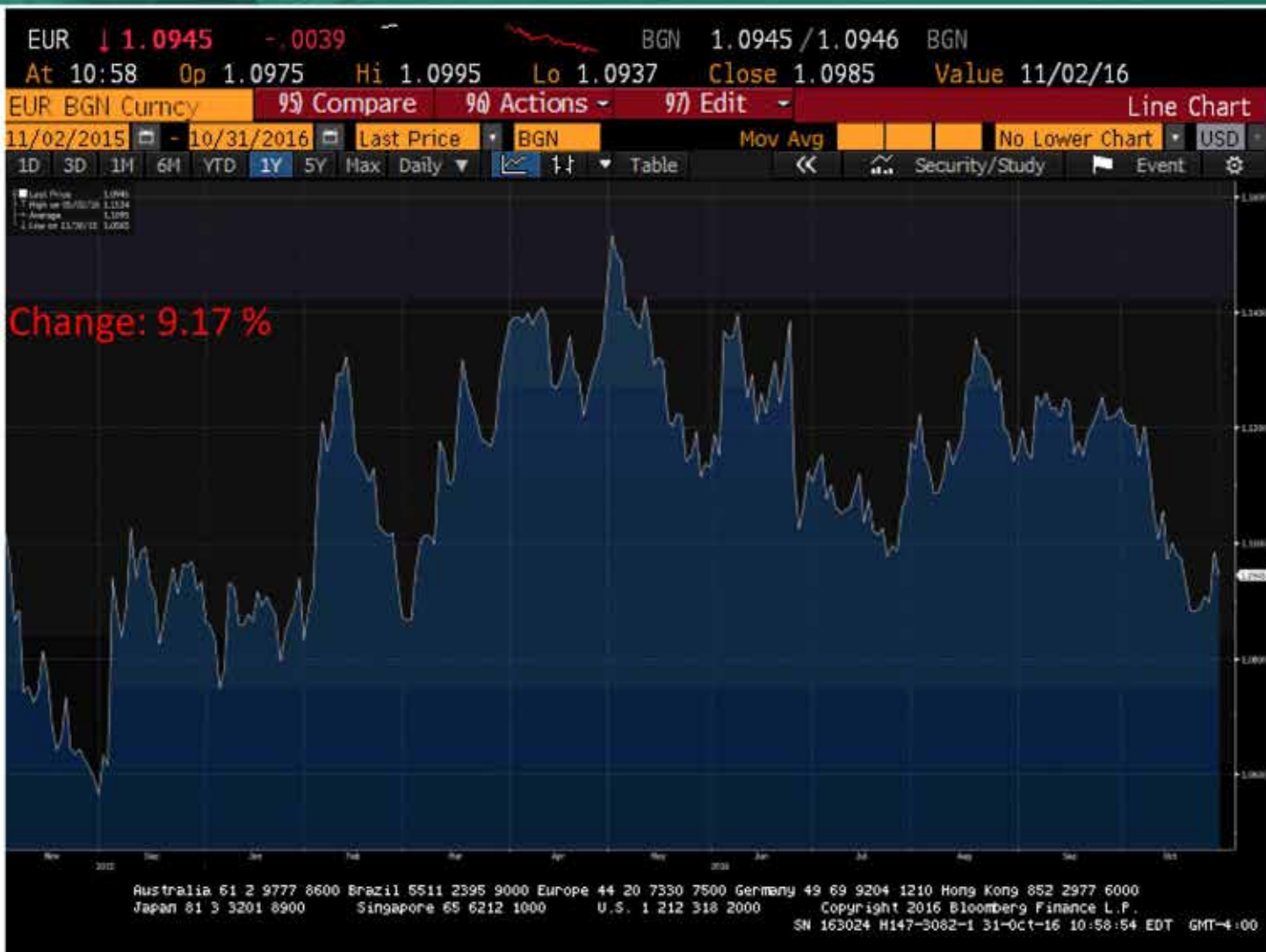
Last Price: 1.2156
 High on 11/02/16: 1.2215
 Average: 1.2185
 Low on 09/11/16: 1.2125

Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000
 Copyright 2016 Bloomberg Finance L.P.
 SN 163024 H147-3082-1 31-Oct-16 10:59:31 EDT GMT-4:00

EUR

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Percent Change: 9.17 %



MXN

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CAD

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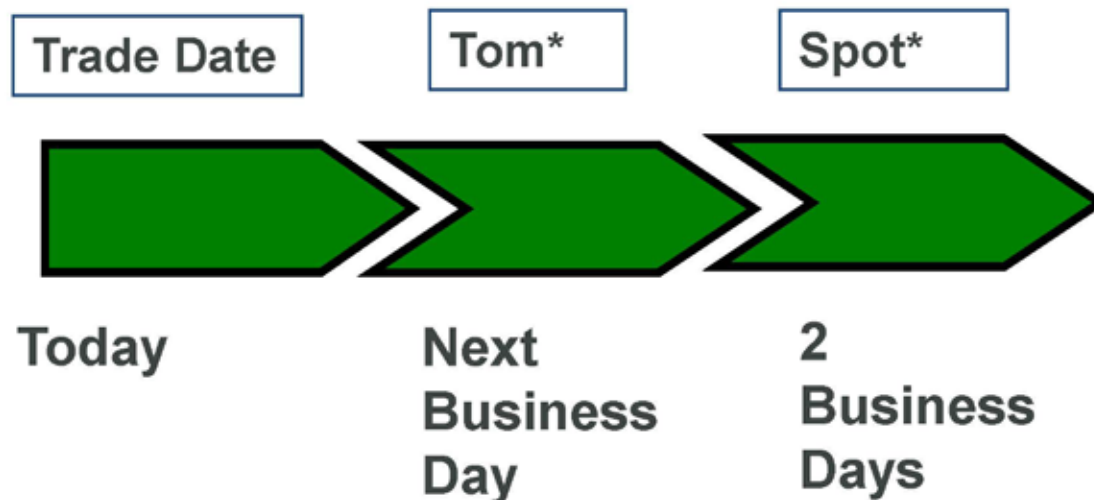


Spot Contracts

Spot

- A contractual obligation to purchase or sell a foreign currency at today's market exchange rate
- The *value date* or final settlement is the second common business day after the trade date

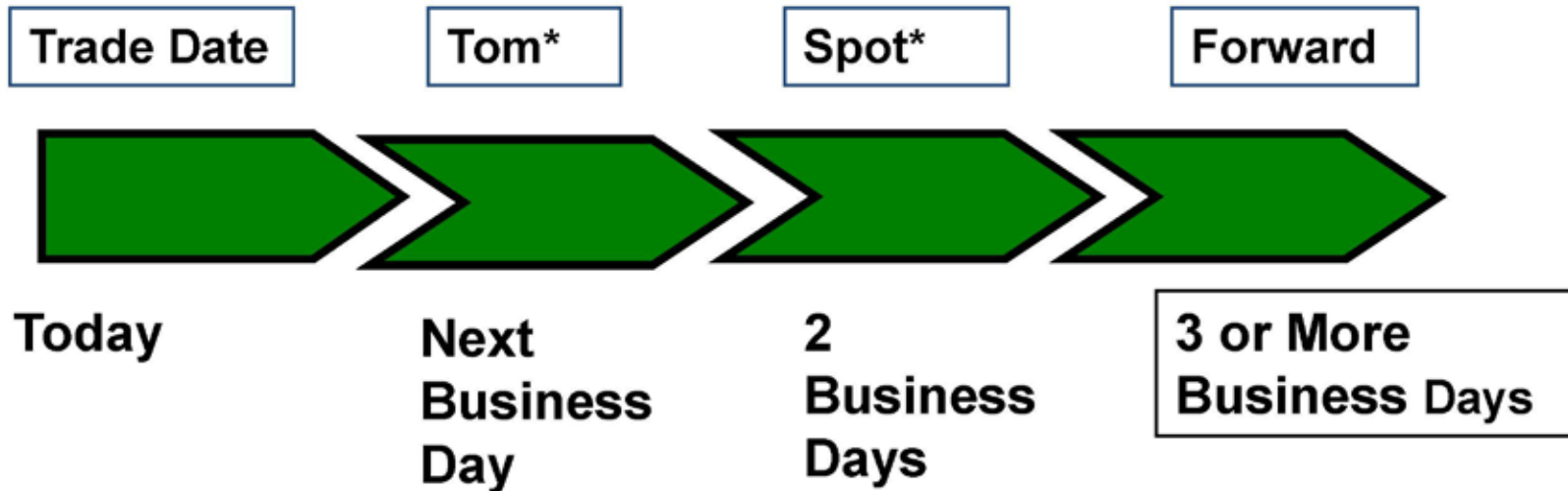
(Except for Canadian Dollars and Mexican Peso which settle on the next business day.)



Forward Contracts

- **Forward**

- A contractual **obligation** to purchase or sell a foreign currency at an agreed upon rate today for settlement on a future date
- The *value date* or final settlement is any date other than the spot date
- Money does not change hands until the value date of the forward contract
- Ideal for customers that want to protect the value of a firm commitment



Forward Contracts

- Forward FX Market Basics
 - Mostly used to hedge future payable/receivable
 - Lock-in financial certainty
 - Not intended to outguess the market
- Forwards available in most currencies with customizable maturity dates
- The relationship between the spot and forward market is based upon the interest rate parity



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Forward Contracts

- Fixed Date – Contracts with an exact value date
- Window – Contracts with a date range for value
 - Typical windows do not exceed 30 day, but can be as long as 90 days
 - Allows flexibility on settlement for uncertain delivery of payment



Internal Considerations

- Consider overall corporate exposure and opportunities
- Devise an internal risk management policy on your overseas exposure
 - What hedging tools if any to use?
 - What department is responsible for function?
 - How do you measure a successful policy?
- Importers-How about asking to be invoiced in local currency vs. dollars?





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